Supreme Court, U.S.
FILED
JUL 30 2004
OFFICE OF THE CLERK

No. 03-1304

IN THE

Supreme Court of the United States

DORIS STIEGLITZ WARD, individually
and on behalf of all others
similarly situated

Petitioners,

v.

STATE OF SOUTH CAROLINA,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

SUPPLEMENTAL BRIEF IN RESPONSE TO THE BRIEF OF THE UNITED STATES

A. CAMDEN LEWIS
LEWIS, BABCOCK & HAWKINS, LLP
1513 Hampton Street
P.O. Box 11208
Columbia, S.C 29211
(803) 771-8000

JOHN M.S. HOEFER
PAIGE JONES GOSSETT
WILLOUGHBY & HOEFER, PA
1022 Calhoun Street, Suite 302
P.O. Box 8416
Columbia, S.C. 29202-8416
(803) 252-3000

CARTER G. PHILLIPS*
VIRGINIA A. SEITZ
DAVID S. PETRON
SIDLEY AUSTIN BROWN & WOOD LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Counsel for Petitioners

* Counsel of Record

July 30, 2004

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTRODUCTION	1
ARGUMENT	3
I. THE DECISION CANNOT BE RECONCILED WITH *DAVIS* AND *WEST LYNN CREAMERY*	3
II. STATE COURTS ARE IN CONFLICT ABOUT THE RELEVANCE OF LINKAGE AND THE PROPER APPLICATION OF *DAVIS*	8
CONCLUSION	10

TABLE OF AUTHORITIES

CASES Page

Almeter v. *Va. Dep't of Taxation*, No. LL-821-4, 2000 WL 1687589 (Va. Cir. Ct. Nov. 6, 2000) ... 9
Complete Auto Transit, Inc. v. *Brady*, 430 U.S. 274 (1977) ... 5
Davis v. *Mich. Dep't of Treasury*, 489 U.S. 803 (1989) ... *passim*
Jefferson County, Ala. v. *Acker*, 527 U.S. 423 (1999) ... 4
Kennedy v. *S.C. Ret. Sys.*, 549 S.E.2d 243 (S.C. 2001) ... 10
Kerr v. *Killian*, 84 P.3d 446 (Ariz. 2004), *petition for cert. filed sub nom. Moran* v. *Hibbs*, 72 U.S.L.W. 3702 (May 3, 2004) (No. 03-1495) ... 2
Lawrence v. *State Tax Comm'n*, 286 U.S. 276 (1932) ... 5
Ragsdale v. *Dep't of Revenue*, 895 P.2d 1348 (Or. 1995) ... 9
Sheehy v. *Pub. Employees Ret. Div.*, 864 P.2d 762 (Mont. 1993) ... 9
Thompson v. *Utah State Tax Comm'n*, No. 20030506-SC (Utah, filed June 13, 2003) ... 2
Vogl v. *Dep't of Revenue*, 960 P.2d 373 (Or. 1998) ... 9
W. Lynn Creamery, Inc. v. *Healy*, 512 U.S. 186 (1994) ... 2, 7, 8

STATUTES

4 U.S.C. § 111(a) ... 1
26 U.S.C. § 164(a)(3) ... 6

TABLE OF AUTHORITIES—continued

SCHOLARLY AUTHORITY Page

Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 Mich. L. Rev. 2167 (1997) 6

INTRODUCTION

In the Public Salary Tax Act, 4 U.S.C. § 111(a), the United States consented to state taxation of federal employees and retirees, but imposed the condition that the tax "not discriminate against the [federal] officer or employee because of the source of the pay or compensation." Enforcing this enactment of the intergovernmental tax immunity doctrine, this Court has held that a state may not exempt state employees' retiree benefits from state taxation without providing the same exemption to federal retirees. *Davis* v. *Mich. Dep't of Treasury*, 489 U.S. 803 (1989). South Carolina did not comply with *Davis*'s remedial mandate of equal treatment for federal retirees, but instead substituted an increase in state retiree benefits for its unlawful state retireee tax exemption; this linkage in this integrated measure intentionally perpetuated the State's discrimination against federal retirees.[1]

In an astonishing and inexplicable brief, the United States now takes a position wholly contrary to the interests of tens of thousands of federal retirees in this case and millions of federal employees and retirees in future cases. Based on a footnote in *Davis*, the United States argues that the intergovernmental tax immunity is an empty formalism that addresses a state's imposition of taxes in isolation from its tax subsidies. According to the United States, South Carolina's admitted linkage between taxing and spending is irrelevant—even where the integrated measure has the purpose and effect of preserving a state's discriminatory tax regime—so long as the federal treasury benefits from the state retirees' increased compensation. U.S. Br. 6-7.

---

[1] The State's admitted purpose behind and the acknowledged effect of enacting Act 189 was "to provide that state retirees do not experience a tax increase." *See infra*, at 9-10.

Petitioner disagrees vehemently with the United States' contention that a state "cures" its unconstitutional discrimination by enacting a facially-neutral tax policy linked to a compensation increase with the avowed purpose and effect of perpetuating discrimination. But the United States' position makes it even more urgent that the petition be granted, because the continuing vitality of the intergovernmental tax immunity doctrine is now at stake. The United States' public position will have substantial influence in Utah and Arizona, where continuing litigation[2] addresses the constitutionality of their States' responses to *Davis*. See Reply 9. The United States' brief also provides States which responded to *Davis* by curing their past discrimination (by exempting federal retirees from taxation or subjecting state retirees to taxation) with a roadmap to restore discrimination and score political points with the important constituency of state retirees.

In this reply, accordingly, we show that the decision below—adopted by the United States—is entirely inconsistent with this Court's precedents. The United States wrongly asserts that *Davis* endorses a purely formalistic intergovernmental tax immunity doctrine that is principally concerned with impact on the federal treasury, rather than discrimination against federal employees and the federal government. And, the United States implausibly attempts to distinguish *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186 (1994)—holding unconstitutional a state's facially neutral tax because the state also paid a subsidy to in-state producers with discriminatory intent and effect—on the asserted ground that the directly analogous dormant commerce clause forbids discriminatory linkage but the intergovernmental tax immunity doctrine does not.

---

[2] *See Thompson* v. *Utah State Tax Comm'n*, No. 20030506-SC (Utah, filed June 13, 2003); *Kerr* v. *Killian*, 84 P.3d 446 (Ariz. 2004), *petition for cert. filed sub nom. Moran* v. *Hibbs*, 72 U.S.L.W. 3702 (May 3, 2004) (No. 03-1495).

We also show that despite the United States' characterization of the decision below as fact-bound, in reality, state courts apply directly conflicting legal standards to claims arising under the intergovernmental tax immunity doctrine, based on their inconsistent interpretations of *Davis*—a conflict especially stark given South Carolina's Tenth Amendment holding. The need for this Court's review is now imperative in light of the importance of the issue (including the numerous federal civilian and military retirees affected), the United States' adoption of the position that the intergovernmental tax immunity doctrine may be facilely evaded, and the clear conflict among the states over the proper application of this Court's precedents.

ARGUMENT

I. THE DECISION CANNOT BE RECONCILED WITH *DAVIS* AND *WEST LYNN CREAMERY*.

A. The United States first argues that Act 189 fully complies with *Davis* "because it 'repealed the tax exemption for state retirement benefits.'" U.S. Br. 5. The Government reads *Davis* as "endors[ing]" its dissent's suggestion "that a State could simply increase benefits to state retirees in order to replace the invalidated tax exemption." *Id.* at 6. Thus, the United States concludes, "*Davis* forbids only discriminatory *taxation*; it does not purport to preclude States from benefiting their retirees in other ways." *Id.* at 7. The United States believes a state's response to *Davis* remedies a constitutional violation unless the state reduces its costs "'at the expense of the federal treasury'"—even if the state's purpose and effect perpetuate discrimination. *Id.* at 6-7.

This reading of *Davis*, based on a footnote in the decision, 489 U.S. at 815 n.4, adopts that of the South Carolina Supreme Court—*viz.*, that the intergovernmental tax immunity doctrine is *solely* about neutral taxation and that a constitutional violation can be cured by perpetuating the

discriminatory treatment of federal retirees using a different fiscal tool (a compensatory increase in benefits). This reading conflicts with the reading of several state courts and with this Court's holding in the analytically analogous area of the dormant commerce clause, as we show *infra*. Equally to the point, for several reasons, this is a profound misreading of *Davis* and the Public Salary Tax Act (which the United States never cites)—a misreading that has exceptional importance precisely because it is *the United States' interpretation* and will have influence in other litigation that will decide whether discrimination has been cured.

First, the United States' overreading of footnote four is inconsistent with the bulk of the *Davis* opinion; in fact, the United States' argument would have footnote 4 nullify the holding of the case. *Davis* consistently focuses on discrimination against federal officers. 489 U.S. at 808-09, 812-13, 816-18 (discussing discrimination against federal employees). And while noting that limiting interference with federal governmental function is important, *Davis* held that "it does not follow that private entities or individuals who are subjected to discriminatory taxation on account of their dealings with a sovereign cannot themselves receive the protection of the constitutional doctrine." *Id.* at 814. Thus, while the United States' position is that the intergovernmental tax immunity doctrine is violated only where there is harm to the federal treasury, "all precedent is to the contrary." *Id.* at 814-15 (citing cases). This court did not mandate equal treatment in *Davis* in order to benefit the federal treasury. The Court was focused on remedying discrimination. Moreover, in remedying discrimination against federal employees, this Court's precedents forbid States to do indirectly what they are forbidden to do directly. Indeed, the Court has expressly instructed that a State's labeling of a fiscal policy does not control the application of the intergovernmental tax immunity doctrine. *See Jefferson*

County, Ala. v. *Acker*, 527 U.S. 423, 439 (1999).[3] South Carolina's contrary ruling violates *Davis*' injunction that past discrimination must be remedied.

In any event, the function of footnote four in *Davis* is not (as the United States would have it) to describe the limits of the intergovernmental tax immunity doctrine but to respond to the *Davis* dissent's argument about the proper class of citizens to compare to federal employees for the purpose of finding unlawful discrimination. Compare 489 U.S. at 824 (Stevens, J., dissenting), with *id.* at 815 n.4. The *Davis* dissent thought it made little sense to compare federal and state employees because in lieu of exempting state retirees' income from taxation, a state could increase the compensation it paid its employees. In response, footnote four noted that a tax exemption and a compensation increase are not always fungible, because the latter "would result in higher federal income tax payments in some circumstances." This suggests only that a state, in considering whether *in the first instance* to provide a tax exemption or a benefit increase to state employees, could not simply substitute a compensation increase for an exemption because a fully compensatory increase would cost more. It cannot remotely be read to authorize the perpetuation of discrimination once discrimination is found.[4]

---

[3] *See also Lawrence* v. *State Tax Comm'n*, 286 U.S. 276, 280 (1932) (with respect to the validity of a tax upon the federal government or its employees, "we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it"); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 288 (1977) (the constitutionality of a state tax does not turn on legislative phrasing because such "formalism merely obscures the question whether the tax produces a forbidden effect")

[4] Clearly, footnote 4 cannot be interpreted, as the United States says, to authorize States to maintain their discrimination by increasing compensation and benefiting the federal treasury. The Court expressly gave states the alternative of removing the exemption. Choosing that option actually *harms* the federal treasury by giving state retirees who

The United States says that a state's "previous[] violation [of] the doctrine of intergovernmental tax immunity" is not relevant to the state's power to increase state retirees' benefits. U.S. Br. 7. This is wrong. *Ab initio*, the State could set retirees' benefits as it saw fit; but once illegal discrimination was found, South Carolina was obligated to restore federal retirees to the position they would have occupied but for that unlawful discrimination. Pet. 20-21. Any other holding defies *Davis*' "mandate of equal treatment." 489 U.S. at 817. The remedial context is critically important, unless linkage is immaterial as a matter of law. And that is an important question that should only be decided by this Court.

---

itemize a new federal tax deduction. Suppose a state increases the compensation it pays its retirees and simultaneously eliminates its pre-*Davis* state tax exemption; the retirees then owe the state additional taxes on the increased compensation. If, for example, taxpayers deducted their state tax payments pursuant to 26 U.S.C. § 164(a)(3) in calculating federal taxable income, the federal tax on the compensation increase is offset by the corresponding deduction for state taxes. *See* Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 Mich. L. Rev. 2167, 2212-13 (1997) (providing similar example involving a business taxpayer). This illustrates that while there might be "some circumstances," *Davis*, 489 U.S. at 815 n.4, in which increased state retiree compensation yields increased federal tax payments, there are other circumstances in which the opposite is true. And the federal treasury surely receives less money under Act 189 than it would if South Carolina had done what footnote four describes: increase compensation in the amount of the lost discriminatory tax exemption *plus* the amount of additional federal taxation on the increased compensation. *See id.*

Accordingly, if the United States' interpretation of footnote four is correct, the boundaries of the intergovernmental tax immunity doctrine are delineated by the vicissitudes of federal tax policy, its interaction with state tax policy, and the aggregate effect of those policies on affected individual taxpayers. That is not what this Court intended in *Davis*. In fact, the intergovernmental tax immunity doctrine is directed at discrimination against federal employees and retirees—and discrimination is not cured by its indirect perpetuation.

B. The United States acknowledges (i) the "'conceptual similarity'" between intergovernmental tax immunity and the dormant commerce clause, U.S. Br. 7 (citing *West Lynn Creamery*, 512 U.S. at 200 n.17), and (ii) that under the latter, a facially neutral tax linked to a compensatory payment to in-state producers results in unconstitutional discrimination, *id.* at 8. It nonetheless contends that *West Lynn Creamery* does not apply to the analysis of similar fiscal schemes under the intergovernmental tax immunity doctrine.

In fact, however, these doctrines serve the related purposes of preventing discrimination that favors in-state interests as against those of other states (the dormant commerce clause) and those of the federal government (the intergovernmental tax immunity doctrine). As explained in the petition (19-20), a state's ordinary political process cannot be trusted to provide equal treatment for out-of-state businesses or federal retirees, if a state can avoid difficult political choices by enacting facially neutral tax policies and paying off state businesses and retirees for the loss of their favored status. See *Davis*, 489 U.S. at 817-18 (requiring states to make the difficult choice); *W. Lynn Creamery*, 512 U.S. at 200 & n.17. Applying *West Lynn Creamery*'s linkage analysis prevents this defect in the political process from yielding a state tax scheme that discriminates against federal retirees.

While the United States is correct that the dormant commerce clause does not apply to states when they act as general market participants, U.S. Br. 8-9, that point is irrelevant here. South Carolina was not acting as a market participant when it passed Act 189, compensating retirees for a lost tax exemption. While setting employment benefits generally is a proprietary function, Act 189 was intentionally linked to the state's amended tax regime and thus was clearly an exercise of governmental power. The linkage between the two renders the integrated enactment unconstitutional.

Accordingly, *West Lynn Creamery* is fully applicable in this setting. This Court held that "[t]he choice of

constitutional means—nondiscriminatory tax and local subsidy—cannot guarantee the constitutionality of the program as a whole." 512 U.S. at 201. Thus, the Court refused to "analyze separately two parts of an integrated regulation," *id.*, and found the linked scheme discriminatory. The decision below and the United States' brief are flatly inconsistent with *West Lynn Creamery*.

II. STATE COURTS ARE IN CONFLICT ABOUT THE RELEVANCE OF LINKAGE AND THE PROPER APPLICATION OF *DAVIS*.

The second part of the United States' brief contradicts the first: If, as the United States says, the intergovernmental tax immunity doctrine is a formal rule about taxation and courts never need to consider whether a benefits increase linked to an exemption repeal has perpetuated a discriminatory tax scheme, there is an inescapable conflict between the decision below and other decisions that have examined whether there is an unconstitutional linkage between a State's taxing and spending measures. Yet after rejecting the legal relevance of linkage, the United States dismisses this conflict among the state courts as attributable to the fact-bound details of the various linked state schemes. The United States cannot have it both ways. Linkage either is or is not legally relevant, and any fair reading of the decisions reveals that the states are in conflict on this fundamental point.

According to the United States, South Carolina did not reject linkage and say that a facially neutral tax law can never be an unconstitutional tax rebate. U.S. Br. 13. This is clearly wrong. The sweep of the decision is evident, holding that: "As long as federal and state retirees are taxed equally, any restriction on this authority [to increase state retirees' compensation] would violate the Tenth Amendment." App. 4a; *id.* at 3a (the Constitution "does not deprive a state of its sovereignty to establish the level of its employees' compensation *so long as the State does not discriminate in taxation*") (emphasis added). Under this rule, the tax rebate

schemes invalidated in *Sheehy* v. *Public Employees Retirement Division*, 864 P.2d 762, 768 (Mont. 1993), and *Vogl* v. *Department of Revenue*, 960 P.2d 373, 379 (Or. 1998), are constitutional because Montana and Oregon taxed federal and state retirees equally. The ruling below plainly conflicts with the analysis and outcomes in *Sheehy* and *Vogl*.

Indeed, not only *Sheehy* and *Vogl*, but also *Ragsdale* acknowledged that the intergovernmental tax immunity may be violated by providing a "partial tax rebate denominated otherwise" if the purpose and effect of the enactment are discriminatory. *Sheehy*, 864 P.2d at 768; *Vogl*, 960 P.2d at 379 ("in the world of intergovernmental tax immunity, substance does count"); *Ragsdale* v. *Dep't of Revenue*, 895 P.2d 1348, 1354 (Or. 1995). The critical point is that these courts have concluded that under a linked tax and compensation scheme with a discriminatory purpose and effect, the increased compensation is a *de facto* tax rebate, while South Carolina (like the United States) has adopted a test that requires only facially neutral taxation.[5]

South Carolina's analysis of *Sheehy* and *Vogl* was undertaken simply to shield its Tenth Amendment holding from review. As demonstrated in our petition (16-18), had the South Carolina court applied the *Sheehy/Vogl* test, it would have acknowledged that Act 189 is a disguised tax rebate. The State's intent to compensate state retirees for the loss of their discriminatorily favorable tax treatment was open and acknowledged. The state supreme court so found. See Pet. 17 (citing three state court decisions). It was admitted by the State's lawyers, see S.C. Mem., R. on Appeal at 172, *Ward* v. *South Carolina*, 590 S.E.2d 30 (filed May 13, 2003);

---

[5] The United States dismisses *Almeter* v. *Virginia Department of Taxation*, No. LL-821-4, 2000 WL 1687589 (Va. Cir. Ct. Nov. 6, 2000) (rejecting the linkage analysis), as irrelevant to a conflict among "'state court[s] of last resort.'" U.S. Br. 11 n.2 (alteration in original). Because the Virginia Supreme Court and this Court declined review, however, *Almeter* is the current law of Virginia regarding compliance with *Davis*.

App. 3a. It was fully supported by all record evidence. See Whitlock Aff., R. on Appeal at 37-40 (Assistant Director of retirement system describing Act 189); 1989 Report of the S.C. Retirement Systems, *id.* at 76 (Director of retirement system explaining that "our retirees' benefit formulas were enhanced so as not to penalize retirees as a result of [Act 189's repeal of the tax exemption]"); Rainwater Dep. Exh. A, *id.* at 91 (describing calculations the state made in calibrating Act 189's benefits "to provide that state retirees do not experience a tax increase").[6]

Given the foregoing, South Carolina clearly did not follow the approach adopted in *Sheehy* and *Vogl*. Instead, it concluded that "[a]s long as federal and state retirees are taxed equally, any restriction in this [compensation] authority would violate the Tenth Amendment." App. 4a. This holding is wrong and merits review.

CONCLUSION

The petition for certiorari should be granted.

---

[6] The United States makes much of Act 189's application to state retirees living outside of South Carolina, arguing that it distinguishes Act 189 from the acts found unconstitutional in other states. Of course, this fact does not distinguish *Vogl*; nor does it distinguish *Davis*, because undoubtedly there were Michigan state retirees who were no longer Michigan residents and thus did not benefit from Michigan's pre-*Davis* exemption. More importantly, the recited fact proves nothing here: Because South Carolina law *requires* uniform treatment of state retirees, *see Kennedy* v. *South Carolina Retirement System*, 549 S.E.2d 243, 250 (S.C. 2001), Act 189's benefit increase was as closely correlated as was legally possible to the increased tax liability resulting from the repeal of the discriminatory tax exemption, and deliberately so.

Respectfully submitted,

A. CAMDEN LEWIS
LEWIS, BABCOCK & HAWKINS, LLP
1513 Hampton Street
P.O. Box 11208
Columbia, S.C 29211
(803) 771-8000

JOHN M.S. HOEFER
PAIGE JONES GOSSETT
WILLOUGHBY & HOEFER, PA
1022 Calhoun Street, Suite 302
P.O. Box 8416
Columbia, S.C. 29202-8416
(803) 252-3000

CARTER G. PHILLIPS*
VIRGINIA A. SEITZ
DAVID S. PETRON
SIDLEY AUSTIN BROWN & WOOD LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Counsel for Petitioners

* Counsel of Record

July 30, 2004